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EX PARTE OR LATE FILED

October 29, 1998

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW
Room 222
Washington, D.C. 20554

RECEIVED
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

NOTICE OF EX PARTE PRESENTATION

Re: CCB/CPD 97-30, Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic; CC Docket No. 98-79

Dear Ms. Salas:

On October 28, 1998, Richard Metzger of the Association for Local Telecommunications Services ("ALTS") and the undersigned, counsel to ICG Communications, Inc., met with Thomas Power, Legal Advisor to Chairman Kennard, to discuss matters of record and current developments in the above-referenced docket. The enclosed handouts formed the basis of the discussion.

Please do not hesitate to give me a call if you have any questions or need any further information.

Sincerely yours,

Albert Kramer

Albert H. Kramer

AHK/rw
Enclosure
cc: Mr. Thomas Power

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ALTS

Association for Local Telecommunications Services

October 29, 1998

HOW TO ASSERT INTERSTATE JURISDICTION OVER DSL TARIFFS WITHOUT IMPAIRING EXISTING INTERCONNECTION CONTRACTS

ALTS understands the Commission is contemplating asserting Federal jurisdiction over the pending DSL tariffs, but that the Commission does not want its action to disrupt existing contracts between incumbents and new entrants for the exchange of traffic. ALTS appreciates the Commission's concern about this important issue, and hereby proposes language that will insure existing contracts are unaffected by the Commission's action. ALTS believes this language also fully preserves the Commission's flexibility to address the appropriate regulatory and cost recovery treatment of ISP traffic while also preserving Commission prerogatives with respect to facilities used to connect to ISPs,[1] and to guide the negotiation and approval of future interconnection contracts.

First, the order should include a finding that none of the pending tariffs meets the statutory definition of exchange access : **While we have found that these tariffs are properly tariffed in the interstate jurisdiction, they do not constitute 'exchange access' as defined in section 3(16) of the Act because they do not originate or terminate any 'telephone toll services' (see BellSouth Comments at 17, and U S WEST comments at 2).**

Second, the order should also include the following findings, depending upon the particular theory of interstate jurisdiction adopted by the Commission:

If the Commission relies upon the jurisdictionally mixed nature of the traffic:

> **We also find that our assertion of jurisdiction over these tariffs does not alter the regulatory treatment of circuit-switched services carrying traffic to ISPs, where we have looked to the states for many years to set rates and supervise carrier-to-carrier compensation. The Eighth Circuit recently upheld our conclusion that the overall costs of such dial-up calls are reasonably recovered at the present time through a combination of intrastate end user rates, and interstate rate elements such as the SLC (Southwestern Bell v. FCC, 153 F.3d 523, 543 (1998)). The traffic in the tariffs before us here utilizes facilities that are very different from dial-up traffic, namely DSL loop technology in conjunction with ATM transport, and**

[1] See Advanced Wireline Services, CC Docket No. 98-147.

thus poses entirely distinct cost recovery issues best addressed by federal tariffing. Accordingly, our decision to exercise active tariff authority over the present filings while leaving undisturbed the existing regulatory environment under which states set the rates for dial-up calls to ISPs and supervise existing contracts among the carriers handling this traffic, is fully within the broad discretion recognized by the Eighth Circuit's order (id. at 544; see also our holding in the ONA Order, CC Docket No. 88-2, Phase I, 4 FCC Rcd 1, para. 308 (1988), that we have discretion to permit provisioning of such facilities pursuant to state tariff), and does not alter any decision the states have made with respect to reciprocal compensation for those calls. Our determination of the jurisdictional nature of this traffic does not affect validity of these decisions, including the classification of this traffic as local under existing interconnection contracts. To the extent we wish to examine any part of this system in the future, including the negotiation and regulatory oversight of future interconnection contracts, we will address that matter in a separate proceeding.

If the Commission relies upon a single call theory:

We also find that our assertion of jurisdiction over these tariffs does not alter the regulatory treatment of circuit-switched services carrying traffic to ISPs, where we have looked to the states for many years to set rates and supervise carrier-to-carrier compensation. And even if our assertion of jurisdiction over the present traffic were applicable to dial-up traffic, we hereby expressly decline to exercise any such jurisdiction at the present time. Instead, we leave undisturbed the existing regulatory environment under which states set the rates for dial-up calls to ISPs, and supervise existing contracts among the carriers handling this traffic. Our determination of the jurisdictional nature of this traffic does not affect validity of these decisions, including the classification of this traffic as local under existing interconnection contracts. Our decision to minimize disruption of state authority is supported by established precedent and policy. For example, in Memory Call, 7 FCC Rcd 1619 (1992), where the state action directly conflicted with our policies, we carefully limited our exercise of jurisdiction to the proposed state-ordered freeze on the provisioning of an enhanced service, but we made no changes to the state's authority over carrier provisioning of the enhanced service involved. Where the states are implementing our policy or acting consistently with our policy, as is the case here, we do not attempt to supplant the exercise of state authority. To the extent we wish to examine any aspect of state supervision of dial-up calls to ISPs in the future,

including the negotiation and regulatory oversight of future interconnection contracts, we will address that matter in a separate proceeding.

If the Commission replies upon its Title I authority over information services:

We also find that our assertion of jurisdiction over these tariffs does not alter the regulatory treatment of circuit-switched services carrying traffic to ISPs, where we have looked to the states for many years to set rates and supervise carrier-to-carrier compensation. Many policy factors that support assertion of our Title I jurisdiction here (such as the need for a national policy in order to encourage investment in new technology) have little application to existing circuit-switched technology, where investments have largely already been made, and services carrying traffic to ISPs represent only a portion of circuit-switched calls. Accordingly, we expressly decline to alter any aspect of the existing regulatory environment under which states set the rates for dial-up calls to ISPs, and supervise existing contracts among the carriers handling this traffic, or any decisions that the states have made with respect to the foregoing. Our determination of the jurisdictional nature of this traffic does not affect the validity of these decisions. To the extent we may wish to examine any part of this system in the future, including the negotiation and regulatory oversight of future interconnection contracts, we will address that matter in a separate proceeding.

Because of the likelihood that incumbent providers will attempt to misuse a jurisdictional finding by this Commission in an effort to overturn existing interconnection contracts as they have been upheld by state agencies, ALTS respectfully but urgently re

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ests that the above language be included in the Commission's order.

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ICG'S POINTS FOR ORDER APPROVING <u>FEDERAL TARIFFING OF DSL SERVICES</u>

I. The Commission must make clear in the DSL tariff order what it is <u>NOT</u> doing:

A. The FCC is <u>NOT</u> ruling that dial-up calls to ISPs are interstate calls, nor that they are not properly treated as local traffic under existing interconnection agreements.

B. The FCC is <u>NOT</u> overturning any state commission decision concerning reciprocal compensation for calls to ISPs. The Commission does not intend to revisit reciprocal compensation decisions made by the states under Section 252. Indeed, the states continue to retain their authority to oversee negotiations of interconnection agreements.

C. The FCC is <u>NOT</u> classifying DSL service as "exchange access," even if DSL services may be tariffed at the interstate level.

II. The actions that can resolve the DSL tariff investigation consistent with maintaining a competitive balance and respecting state authority are:

A. Allowing the tariffs for DSL service to stay in effect because DSL service can have interstate applications. The Commission should not make a determination about the jurisdictional nature of calls to ISPs.

B. Consider long-term solutions in a separate proceeding.

III. This approach, which is entirely consistent with the integrity of the Telecommunications Act of 1996, accomplishes the following:

A. The Commission retains the flexibility to weigh in with policy guidance on ISP issues in the interconnection context, whether in the companion proceeding to the tariff order or elsewhere in a pending or broader proceeding.

B. Does not create a regulatory lapse or foster uncertainty in the interim.

C. Provides the FCC with full flexibility to address prospectively reciprocal compensation issues.

D. Preserves the role of the states.

ICG'S POINTS FOR ORDER APPROVING
<u>FEDERAL TARIFFING OF DSL SERVICES</u>

I. **The Commission must make clear in the DSL tariff order what it is <u>NOT</u> doing:**

A. **The FCC is <u>NOT</u> ruling that dial-up calls to ISPs are interstate calls, nor that they are not properly treated as local traffic under existing interconnection agreements.**

1. The Commission need not make any determination in the context of the tariff investigation about the jurisdictional nature of calls to ISPs or any other Internet-related calls.

a. The Commission should avoid making a "one call" or a "point-to-point" finding that would classify a call to an ISP as interstate.

i. With a call to an ISP, there are two services at issue: (1) the local, intrastate call to the ISP (which is an end user of the serving LECs' telecommunications service); and (2) the information service the ISP provides to its customer (which is not a regulated telecommunications service at all, whether intrastate or interstate in nature).

b. Whatever the jurisdictional nature of an Internet communication, the telecommunications service connecting a caller to an ISP is intrastate.

2. Finding that calls to ISPs are interstate would amount to a reversal of the Commission's course, which would be inconsistent and inequitable, and would likely undermine the progress of local competition and send the wrong signal to the financial markets.

B. **The FCC is <u>NOT</u> overturning any state commission decision concerning reciprocal compensation for calls to ISPs. Nor will the Commission examine such decisions by the states. Indeed, the states continue to retain their authority to oversee negotiations of interconnection agreements.**

1. The Commission should also make clear that as a matter of policy it does not intend to reexamine decisions made by the states in exercising their authority under Section 252.

a. The decisions by the state commissions interpreted provisions of interconnection agreements or resolved disputes in arbitration proceedings, consistent with state authority under Section 252 of the Act.

b. Unless the Commission forecloses application of its ruling to dial-up calls to ISPs, there will be confusion and uncertainty in state proceedings about the extent of the Commission's findings.

c. The Commission should not be in the position of modifying agreements entered into by the parties.

2. The need to respect existing state law determinations is particularly apparent in the area of reciprocal compensation for calls to ISPs.

a. It is not possible to reliably identify calls to ISPs from other local calls.

b. Many calls to ISPs never leave the ISP's intrastate platform.

c. Twenty-one (21) states have already examined the issue of reciprocal compensation for calls to ISPs. In addition, NARUC has recently adopted a second resolution in less than a year asking the FCC to coordinate with the states before taking any action on this issue.

C. **The FCC is <u>NOT</u> classifying DSL service as "exchange access," even if DSL services may be tariffed at the interstate level.**

1. Classifying DSL service as "exchange access" would be inconsistent with state supervision of carrier-to-carrier compensation for calls to ISPs.

2. There are significant policy considerations that would be implicated by an "exchange access" classification:

a. Because most reciprocal compensation agreements expressly exclude "access" traffic, the ILECs would likely argue to the states that *all* calls to ISPs, including "dial-up" calls, are interstate in nature and therefore "access."

b. DSL traffic would be exempted from the Act's interconnection requirements.

3. DSL service does not bear the indicia of exchange access.

a. It does not involve "the origination or termination of telephone *toll* services."

b. It fails to qualify as a Part 69 exchange access tariff both because: (1) it is a point-to-point communication within the same state; and (2) it fails to provide access to an IXC's POP.

c. It would be inconsistent with Commission policy exempting ISPs (as end users) from access charges to classify as "exchange access" a service that GTE admits is for end users.

d. Under the Commission's rules, "access service" involves "interstate or foreign telecommunication." No such "interstate *telecommunication*" is associated with DSL calls, no matter how one classifies the information service provided by the ISP.

II. **The actions that can resolve the DSL tariff investigation consistent with maintaining a competitive balance and respecting state authority are:**

A. **Allowing the tariffs for DSL service to stay in effect because DSL service can have interstate applications. The Commision should not make a determination about the jurisdictional nature of calls to ISPs.**

1. Because the ILECs' proposed DSL services may sometimes have interstate applications, there is no bar to tariffing such services at the federal level.

a. It is theoretically possible for a "point-to-point" Internet "communication" to be interstate, but the two underlying services remain distinct.

i. The ISP platform initiates a completely new service that is an information service.

ii. The ISP platform is not an "intermediate switching point" within an "unbroken" communication.

2. DSL services may also be tariffed at the intrastate level.

3. A decision to allow DSL services to be tariffed at either the federal or state levels would not change the continued availability of DSL services.

B. **Consider long-term solutions in a separate proceeding.**

1. ISP "exemption" from access charges.

2. Appropriate compensation arrangements.

a. To the extent that the Commission chooses to make any ruling on reciprocal compensation for calls to ISPs, such action should be made with a continuing role for the states in regulating the details, such as end user rates and carrier-to-carrier compensation.

i. The Commission has the option of allowing the states to address these compensation issues pursuant to their Section 252 authority over interconnection agreements.

ii. If the Commission chooses to resolve reciprocal compensation issues itself, it should signal its intention to explore all compensation issues in a full rulemaking proceeding – whether a pending proceeding where the issue has been raised, or in a new proceeding initiated to explore reciprocal compensation issues.

ALTS

Association for Local Telecommunications Services

ILECs will tell you that dial-up traffic to the Internet is not included in Reciprocal Compensation Agreements

Fact of the matter is that the State Commissions say otherwise

- 23 of 23 State Commissions have ruled in favor of the CLECs. These 23 states cover over 70% of the total U.S. population and over 70% of the total phone lines. States are:
- AZ, CA, CO, CT, FL, IL, MA, MD, MI, MN, MO, NC, NY, OH, OK, OR, PA, TN, TX, VA, WA, WV, WI

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PaineWebber
RESEARCH NOTE
October 25, 1998

The Beginning of the End for ISP Recip. Comp.

KEY POINTS

- Our Washington sources tell us that the FCC intends to assert jurisdiction over both dedicated and dial-up access to Internet service providers (ISPs) and on line service providers (OSPs) in upcoming orders and notices, classifying them as interstate telecommunications services.
- Economic, procedural, and political realities have forced the FCC to finally address the regulatory status of ISP/OSP access, two years after the first petition for clarification on this issue was submitted.
- This decision has big implications for the current debate over the payment of reciprocal compensation for calls to OSPs and ISPs and potentially for the cost structures of OSPs/ISPs. We do not believe that this policy statement will include any attempt to force ISPs/OSPs to contribute to Universal Service or to pay exchange access fees in the near term.
- We estimate that (ILECs) are net payers in 1998 of more than $600 million in reciprocal compensation payments to competitive local exchange carriers (CLECs) for OSP and ISP access, and we believe that ILECs may defy state regulator orders to pay reciprocal compensation under existing interconnection agreements given the new FCC policy.
- Its very difficult to determine ultimate winners and losers because disputes over jurisdiction and interconnection agreements will likely end up in court, but it may become much more difficult for CLECs to collect money owed to them under interconnection agreements in the short-term due to this policy statement.
- The largest potential beneficiaries of the upcoming policy statement are the Regional Bell Operating Companies, and we have included estimates of the potential earnings benefit in this note. CLEC investors should evaluate the exposure of the companies they own to reciprocal compensation revenue for ISP/OSP traffic, and ISP/OSP investors should check to see whether pricing for local service from CLECs is protected under multi-year contracts.

Policy on ISP access coming soon

Do all good things come to an end? We'd like to think not, but it appears like a great little regulatory windfall for competitive local exchange carriers is about to end. Our Washington sources have told us that the FCC will soon rule that access to Internet Service Providers (ISPs) and on line service providers (OSPs) are interstate telecommunications services and thus fall under FCC regulatory jurisdiction. In so doing the FCC will for the first time articulate its policy in this area. This will likely bring to an end the large net payments from incumbent local exchange carriers (ILECs) to competitive local exchange carriers (CLECs) for providing local exchange connections to ISPs and OSPs.

The vehicle(s) for this policy statement will be an upcoming order on a GTE special access tariff filing and a companion Notice of Inquiry (NOI) or a Notice of Proposed Rulemaking (NPRM). The FCC must rule by 10/29/98 on a GTE interstate tariff of its DSL access for Internet service and the companion Notice could be issued at the same time or shortly thereafter. It is unclear at this point whether the FCC will make specific comment on existing interconnection agreements covering reciprocal compensation for ISP/OSP traffic in either the GTE order or a companion Notice. The FCC lost the jurisdictional battle in the Eighth Circuit Court over enforcement of interconnection agreements, but it may offer an olive branch to the states by trying to limit the applicability of this policy statement to traffic covered under future interconnection agreements, not current ones. Many of the significant interconnection agreements expire in 1999.

Importantly, we do not expect any reversal of the FCC's policy on the ISP/OSP exemption from Universal Service contribution, and we do not expect the FCC to require ISPs/OSPs to pay exchange access fees any time in the near future. The upcoming policy decision on jurisdiction over access to ISPs/OSPs is not linked to one involving the duty to subsidize basic telephone service.

Background on Jurisdictional Issues

The regulatory status of ISP/OSP access is an issue that the FCC has been slow to address. In fact, there has been a petition for clarification on this issue pending for two years at the FCC, and the FCC has taken the maximum allowable time of five months to reply to the GTE request for tariff approval. We believe that the delay was largely a function of the FCC's aversion to additional jurisdictional turf battles with state regulators. The reason for the turf battle over ISP/OSP access is that states consider this a local service. In fact, all 22 state regulators that have rendered decisions on challenges of the regulatory status of "dial-up" (i.e., a call processed through a local exchange switch) access to ISPs have ruled that it is local in nature. Just last week, both

California and Massachusetts regulators ruled in this way, perhaps offering some helpful guidance to the FCC ahead of the ruling on the GTE tariff. The Eighth Circuit Court gave the states the right to enforce interconnection agreements, and 22 state commissions which have looked at this issue have ordered ILECs to pay reciprocal compensation for calls that their customers originate to ISPs/OSPs that are served by CLECs.

In addition, the only parties voicing loud objection to the classification of access to ISPs/OSPs have been the ILECs, which we estimate be net payers of more than $600 million in reciprocal compensation to CLECs. The most outspoken critics have been the Regional Bell Operating Companies (RBOCs), a group for whom the FCC has shown scant sympathy in the past.

Importantly, we believe that all telecommunications traffic will likely migrate to IP networks over time, and we believe that the FCC does not want to leave regulation of such an important issue, access to IP networks, to the states. The issue of jurisdiction is a thorny one, however, because Internet Protocol (IP) networks don't fit conveniently in the state/federal jurisdiction split due to the fact that users can send and receive information to and from servers within and outside of a state in a single connection to an IP network.

Why is the FCC Finally Deciding This?

Due to the technology change and the shift to IP networks, we thought that the FCC would have to rule on the issue of jurisdiction over ISP/OSP access at some point. But why now? We believe that economic, procedural, and political realities have forced the FCC's hand, two years after the first petition for clarification on this issue was submitted.

The economic reality is that reciprocal compensation is no longer a small issue due to the large growth in reciprocal compensation payments. With Internet volumes doubling every four months, the $600 million tab that the RBOCs are on the hook for in 1998 could quickly grow too much larger sums.

The procedural reality is the GTE special access filing, which essentially forces the FCC to answer the jurisdictional treatment of "dedicated" access to ISPs/OSPs. Importantly, we believe that the FCC must rule that "dial-up" access to ISPs/OSPs is interstate traffic also if it does so for "dedicated" services. There can be no functional distinction between the two for jurisdictional purposes.

The political reality is that 1999 is the year we elect a new president in this country, and we believe that Vice President Gore wants to have a federal control over ISP/OSP access so that he can implement and take credit for policy decisions in this area.

Ramifications for Industry Participants

Its very difficult to determine ultimate winners and losers because disputes over jurisdiction and interconnection agreements will likely end up in court. Some ILECs have withheld payments to CLECs for reciprocal compensation for calls to ISPs/OSPs claiming that it is not covered under the interconnection agreements. Moreover, we believe that ILECs may defy state regulator orders to pay reciprocal compensation under existing interconnection agreements given the new FCC policy even if the FCC tries to grandfather existing interconnection agreements. We believe that the ILECs would have a strong argument here because access to ISP/OSP networks can't suddenly change from intrastate to interstate. If it's interstate than it was always interstate. To be sure, ILECs may be contractually bound to pay this money under existing agreements. Although we have not examined the interconnection agreements, we understand that most agreements require reciprocal compensation for traffic that originates and terminates in a local calling area. Courts will ultimately have to interpret these contracts, deciding whether ISP/OSP access is local termination.

A CLEC relying on reciprocal compensation for ISP/OSP for operating capital may be disadvantaged by this development. It could also prompt a CLEC to adopt more conservative policy toward recognition of revenue from reciprocal compensation for ISP/OSP access. We encourage investors to evaluate the exposure of the companies they own to reciprocal compensation revenue for ISP/OSP traffic. MCI WorldCom generates the most income from this source of all the carriers in our coverage universe. We estimate that it represents approximately $0.05 per share in earnings in 1998. Management has told us that it is not budgeting any reciprocal compensation income in its 1999 operating estimates and is confident in a $2.00 per share EPS estimate without this income. Look for a note from PaineWebber's CLEC analyst, John Hodulik, on the exposure of the CLECs he follows.

OSP/ISP investors should check to see whether pricing for local service from CLECs is protected under multi-year contracts. CLECs are the major suppliers of local circuits to ISPs/OSPs, and we believe that the availability of reciprocal compensation revenues has allowed them to offer low prices. OSP/ISP costs could go up under the new FCC policy.

We list the estimated 1998 expense accrued for reciprocal compensation for ISP/OSP for four of the large ILECs below. Ameritech and BellSouth do not disclose these numbers, but we estimate that they collectively account for more than $200 million in exposure.

BEL: $250 million or $0.10 per share

SBC: $150 million or $0.05 per share

USW: $35 million or $0.04 per share

GTE: $15 million or $0.01 per share

We believe that the large ILECs will continue to accrue for reciprocal compensation for ISP/OSP expenses pending the outcome of court cases. These expense accruals may be hidden sources of earnings if the ILECs are successful in legal challenges.

Additional information available upon request.